



SQUARE D COMPANY 1978 ANNUAL REPORT

AR20



Square D Company

Executive Offices

Executive Plaza, Park Ridge, Illinois 60068
(Incorporated in State of Michigan 1903)

Annual Meeting

Fourth Tuesday in April

Capital Stock Listing (SQD)

New York Stock Exchange

Transfer Agents and Registrars

National Bank of Detroit
611 Woodward Avenue
Detroit, Michigan 48226

Morgan Guaranty Trust Company of New York
30 West Broadway
New York, New York 10015

Shareholders of Record

17,600

Employees, Worldwide

19,800

Dividend Reinvestment Service

Information concerning the Automatic Dividend Reinvestment Service which provides a simple method to reinvest automatically your dividends and additional funds toward purchase of the company's common shares can be obtained by writing to:

Square D Company
Secretary
Executive Plaza
Park Ridge, Illinois 60068

Directors

*PAUL A. CHRISTENSON
President and Chief Operating Officer

•DONALD C. CLARK
President, Household Finance Corporation
Finance, merchandising, manufacturing,
rental and leasing, Chicago, Ill.

W. R. CLARKE
Vice President—Marketing

*M. P. KARTALIA
Chairman and Chief Executive Officer

•JAMES H. LORIE
Professor of Business Administration
University of Chicago, Chicago, Ill.

*JAMES F. MAGIN
Vice President—Planning and
Physical Distribution

GRANT McDONALD
Retired (Former Vice President—
Group Manager)

•WILLIAM C. MESSINGER
Chairman, Rexnord Inc.
Diversified industrial products,
Milwaukee, Wisc.

•GUSTAVE H. MOEDE, JR.
President, Wisconsin Telephone
Company, Milwaukee, Wisc.

•T. R. OAKES
Retired (Former Vice President—
Secretary-Treasurer of the Company)

•ANDREW L. PONTIUS
Retired (Former President, The Powers
Regulator Company, Skokie, Ill.)

*JAMES I. POOLE
Senior Partner, Foley and Lardner
Attorneys, Milwaukee, Wisc.

JOHN E. STRUGGLES
Co-founder and principal officer
Heidrick and Struggles, Inc.
Management Consultants, Chicago, Ill.

J. S. VAUGHAN
Vice President—Manufacturing

DONALD E. WILSON
Vice President—Finance, Secretary and
Chief Financial Officer

*Members of Executive Committee
•Members of Audit Committee

Officers

M. P. KARTALIA
Chairman and
Chief Executive Officer

PAUL A. CHRISTENSON
President and
Chief Operating Officer

W. R. CLARKE
Vice President—Marketing

JOHN N. DANIEL
Vice President—Group Manager

DEXTER S. FREE
Treasurer

PAUL R. GOUDY
Vice President—Engineering

SAM C. HUNT
Vice President—Products

GLENN R. HUNTER
Vice President—Group Manager

R. E. KING
Vice President—Group Manager

JOHN F. LaSHORNE
Controller and Chief Accounting Officer

JAMES F. MAGIN
Vice President—Planning and
Physical Distribution

WALTER G. NOLLENBERGER
Vice President—Group Manager

R. E. SHERIDAN
Vice President—Overseas Manufacturing

KENNETH R. STULL
Vice President—Overseas Marketing

J. S. VAUGHAN
Vice President—Manufacturing

JAMES M. VETTA
Vice President—Personnel Relations

DONALD E. WILSON
Vice President—Finance, Secretary and
Chief Financial Officer

ANNUAL REPORT FOR THE YEAR ENDED DECEMBER 31, 1978

Summary of Operations

(000 Omitted)

	<u>1978</u>	<u>1977</u>
Sales	\$726,862	\$610,754
Net Earnings		
Before Taxes	130,789	116,745
After Taxes	66,657	58,924
Per Sales Dollar	.09	.10
Per Share	2.80	2.47

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Cover

The cover of our 1978 Annual Report symbolizes the projected growth over the next ten years of different sectors of the economy served by the electrical industry. Our Report tells how Square D Company continues to expand its operations in preparation for this projected growth.



To Our Shareholders:

In 1978, for the third consecutive year, Square D Company achieved record sales, earnings and earnings per share.

Consolidated net earnings in 1978 were \$66,657,000, or \$2.80 per share, compared to \$58,924,000, or \$2.47 per share in 1977. The 1978 earnings amounted to \$.09 net per sales dollar. Consolidated net sales for the year were \$726,862,000. This compares to \$610,754,000 for 1977. In these days of ever-increasing taxation, it is noteworthy to mention that in 1978 your company incurred a total of \$86,525,000 in Federal, State and local taxes, a new record. When you add to this the additional taxes our shareholders will pay on their dividends, you get some idea of the large portion of the company's income which goes to the combined governmental taxing agencies.

YEAR'S HIGHLIGHTS

Let's review some of the highlights of 1978.

In December, the Board of Directors announced a quarterly dividend increase from 35 cents to 37½ cents, the present level. This was the third increase declared in dividends in the last two years and the sixth in the last seven years.

In September, we announced that existing labor agreements due to expire in 1978 were replaced with new agreements scheduled to expire on September 30, 1981. Negotiations again this year were conducted on a national coordinated basis with no work stoppages or disruption of service to our company's customers.

Our domestic facilities expansion program during 1978 was the most extensive in our company's history and continues at a rapid pace. It affects ten separate domestic sites and involves almost one million square feet of new space. Although a part of this new space will replace smaller existing facilities, the major portion of the new construction will be additional space. The expansions will make us more efficient and add further to our production and service capabilities. Because of the extensive nature of our domestic construction program, we will devote further space to it later on in this report.

In the international area, the manufacturing plants established in Costa Rica, Brazil and Ecuador are now in various stages of operation and will allow Square D Company to get involved even further in the growing market for electrical products in Central and South America.

In February, we acquired Starkstrom Gummersbach, an established West German firm which manufactures industrial control equipment and has two plants in West Germany. This acquisition allows the company to expand its activities in international markets. Also in Europe, we expanded our manufacturing plant in Ballinasloe, Ireland, to provide added production capabilities.

In March, your Board of Directors approved a definitive Agreement and Plan of Merger whereby Globe-Union, Inc., a Milwaukee manufacturer of batteries and electronic products, would be merged into Square D Company. This Agreement was terminated in July by mutual consent when Globe-Union became involved in a merger agreement with another company.

RESEARCH AND DEVELOPMENT

We continued in 1978 to be in the forefront in product research and development. Not only did we introduce several significant new products but one of our recent developments, a lithium alloy used in contacts in some of our equipment, received national recognition during the year as being one of the 100 most significant technical products introduced in 1977.

One of the products resulting from our research and development program was SY/MAX-20™, a new, compact programmable controller. Another was the WATCHDOG™ Energy Management System. Both already have made an impact on industry. With the tremendous emphasis on innovation in the energy-saving area, Square D Company also has expanded its line of heat pumps and electrical furnaces, products designed to help in the conservation of energy. Details on some of our products are presented later on in this report.

MANAGEMENT CHANGES

We made several important management changes during 1978.

Paul A. Christenson was elected President and Chief Operating Officer on April 25. Mr. Christenson has 36 years of experience with Square D Company in both Marketing and Manufacturing and has served as a member of the Board of Directors since 1965.

Robert E. Sheridan, formerly Vice President-International, was appointed Vice President-Overseas Manufacturing and became responsible for all manufacturing operations in Europe, Australia and South Africa. He is headquartered in England.

Kenneth R. Stull was promoted to Vice President-Overseas Marketing and made responsible for all marketing operations in Europe, Africa, Australia, the Middle East and the Orient. He also is headquartered in England.

Paul R. Goudy was elected Vice President-Engineering and has companywide responsibility for coordinating all product research, development, design and engineering activities.

OTHER HIGHLIGHTS

Our management training, employee orientation, affirmative action and communications programs have been expanded. We continue to stress that our people are the reason for our present accomplishments and the key to future success. Our training programs have been designed to give these people the opportunity to learn more about their present jobs and prepare them for greater responsibilities in the future. The orientation programs are tailored to give our employees a better understanding of the company, the products we make, the markets we serve, and their expected contributions to our continued success. Our staff and operating executives are in close contact with all their operations to assure that all training, orientation, communications and affirmative action objectives are attained.

We are looking forward to the move into our new corporate headquarters building which should be ready for occupancy by this summer. Located in Palatine, Illinois, this facility will alleviate our present space problems. Corporate operations now are housed in four separate facilities. Having all our corporate employees at one facility will assure better coordination and more efficient operations. The building has been designed to allow for future additions.

We continue to be optimistic about the future of both the electrical industry and our company. Despite increasing inflation, the concern over taxes, expanded government intervention, and the normal problems that face any business entity, we feel that the acceptance of our quality products and our excellent marketing and distributor organizations will allow us to obtain an even greater share of the available business. Our manufacturing facilities and the Physical Distribution System did an excellent job of meeting increased demand in 1978. With the further expansion of our manufacturing facilities, the new distribution center, and quality people throughout our company, we will be in an even better position to meet future demand and assure even greater success for Square D Company and all associated with it.



M. P. Kartalia
Chairman and
Chief Executive Officer

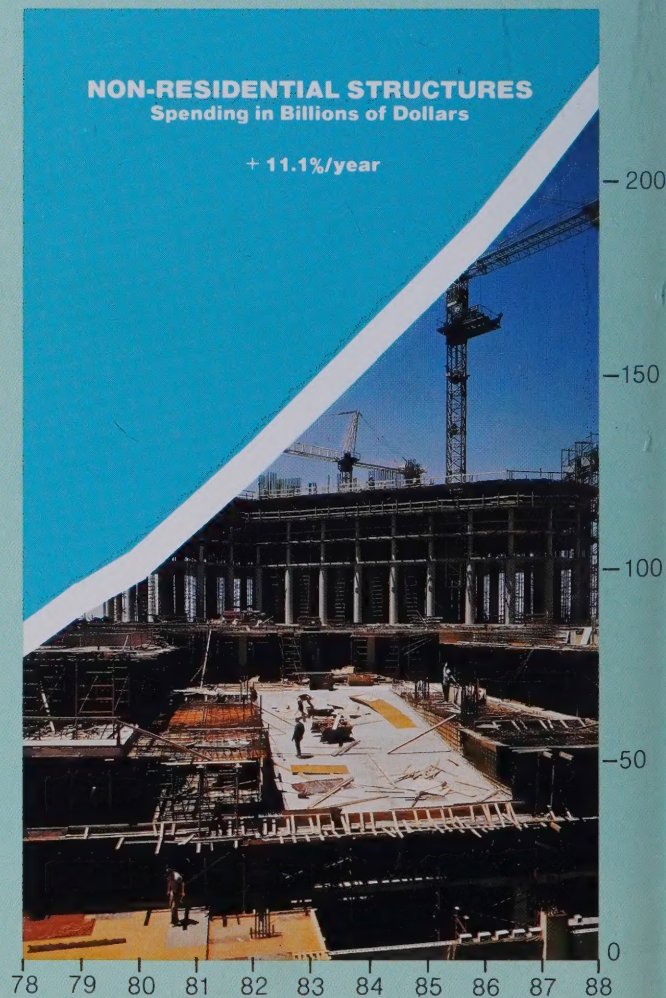
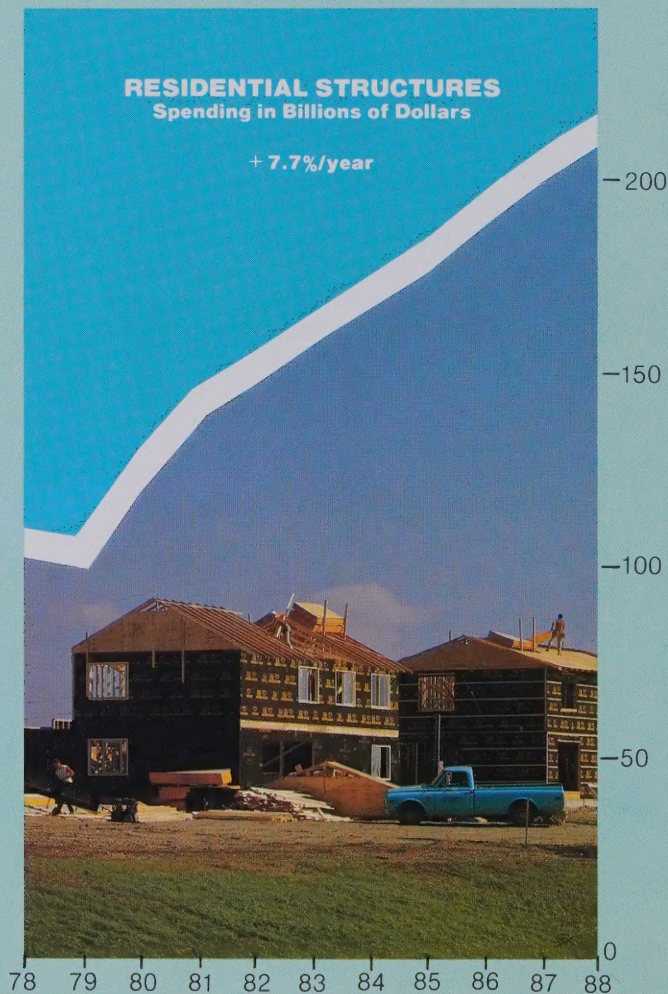
March 1, 1979

The Electrical Industry . . . Growth and Opportunity

Square D traditionally has served those markets connected with the fixed investment sector of the economy. This includes all types of capital formation such as new housing construction, non-residential building construction and capital equipment purchases. The graphs on these pages illustrate the potential for growth that will be available to Square D from these sectors of the domestic economy over the next ten years.

As indicated in the president's letter to shareholders and the pages following this section, Square D Company is prepared to take advantage of the growth years ahead.

RESIDENTIAL CONSTRUCTION—Residential building activity, which has been extremely high over the past two years, is expected to remain strong over the next decade. Forecasts also indicate that the trend for increased consumption of electricity in the home will continue high and that the electrical equipment content of new residential construction will also continue to rise. These



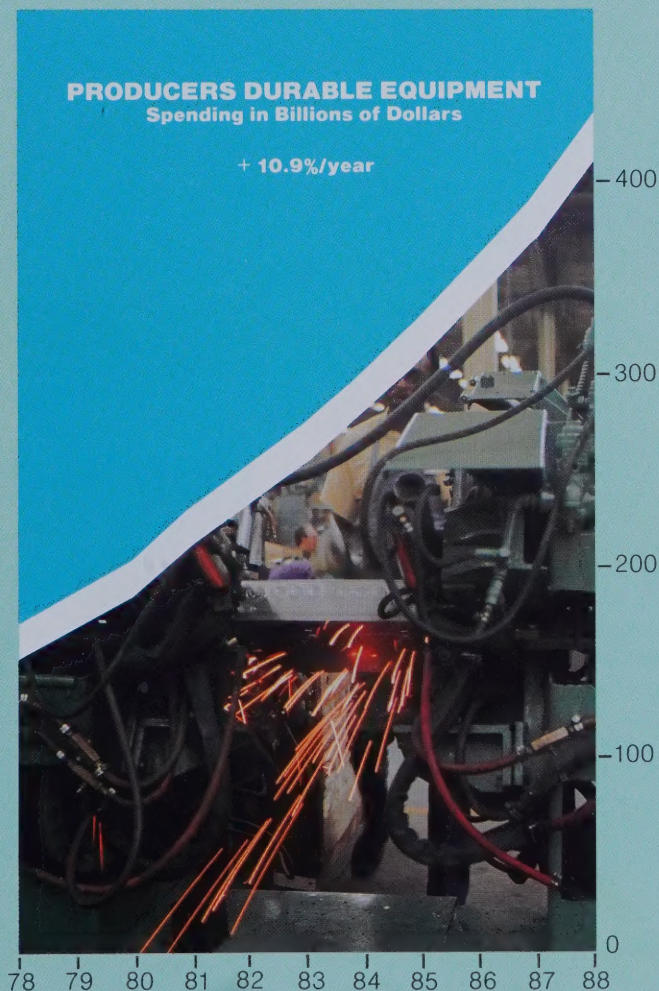
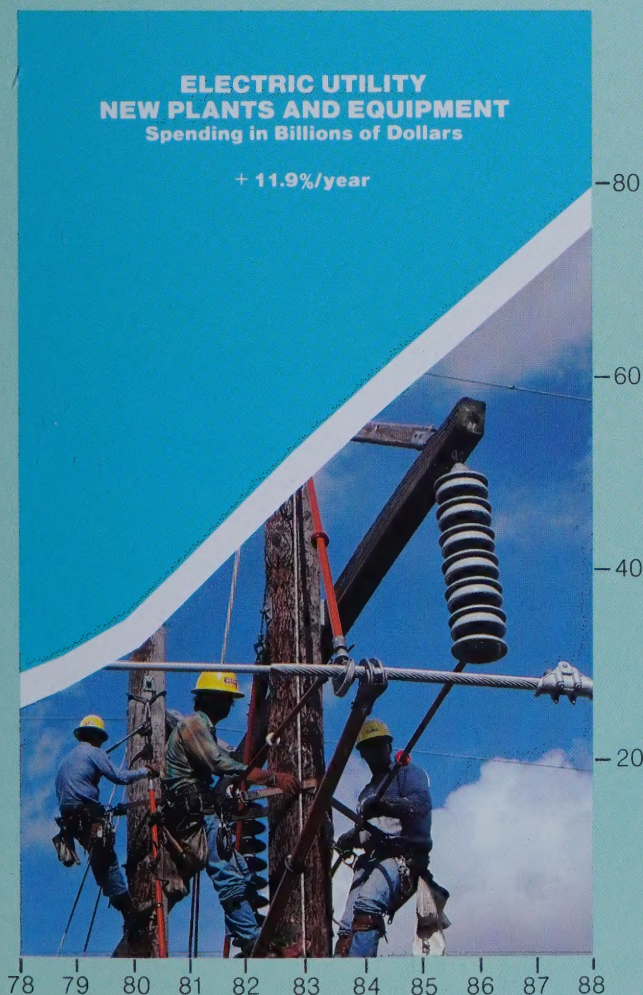
trends indicate continued high demands for Square D's new and traditional lines of electrical equipment used in residential construction.

CAPITAL EQUIPMENT—In the business investment sector, Merrill Lynch Economics, a leading economic forecasting firm, estimates that, "Beyond 1979, businessmen are poised for a long-term thrust toward significant capital formation. As a result, the business investment sector could become the growth pacesetter through the 1980's . . . Plant and equipment outlays over the next ten years are expected to outpace industrial output as manufacturers make a concerted effort to increase productivity, improve efficiency and conserve energy."

NON-RESIDENTIAL CONSTRUCTION—After recovering very slowly from the last recession, spending on non-residential structures increased dramatically during 1978. This investment sector, which includes commercial, industrial and other types of non-residential building activity, also is expected to advance rapidly over the next

ten years. This should lead to increased demand for those Square D products used in such applications, some of which are custom-built to specifications. Merrill Lynch Economics also forecasts that construction of warehousing facilities and retail stores should be especially strong as the economy expands and the demand for goods and services increases.

UTILITIES—Another important market for Square D products involves electrical utilities. Presently, it appears that the consumption of electricity should advance at an average annual rate of approximately 5% per year through 1988. Over the long-term, the use of electricity will continue to outpace over-all energy demand. By 1990, it is estimated that electricity generation should comprise approximately 40% of our total energy requirements compared to 30% in 1977. The long-term Merrill Lynch Economics outlook indicates that, "Although the 5% rate of growth is below the 7-8% annual pace maintained in the middle and late 1960's, it still constitutes strong pressure for utilities to continue expansion."



Source: Merrill Lynch Economics

Expanding to Meet Both Present and Future Demand

To meet the present increased demand for electrical products, and to be ready for the continued growth of the electrical industry described on the preceding pages, Square D has launched the most ambitious expansion program in its history. New or expanded facilities at ten separate domestic sites will add nearly one million square feet of new manufacturing, office, warehouse and laboratory space, the majority of which will be completed by the end of 1979.

NEW PLANTS

Our new circuit breaker plant in Columbia, Missouri, is in production. The 150,000 square-foot building has a fully automated Square D temperature control system and a unique computer-managed plating system.

Work continues on our new plant in Asheville, North Carolina. Located adjacent to our original Asheville plant, it will manufacture pushbuttons, pilot lights, terminal blocks, foot switches, master truck controls, drum switches and control stations. When completed late in 1979, the building will add 102,000 square feet to the Asheville complex. An energy-saving system being installed will reclaim heat from manufacturing operations and use it to heat the building.

ADDITIONS TO PLANTS

Completed during 1978 were additions to five existing facilities. A 30,000 square-foot addition to our Peru, Indiana, plant has increased steel fabrication capabilities and provides storage space for essential components. An 8,000 square-foot addition to our Atlanta, Georgia, assembly plant provides space for expanded switchboard assembly; while a 9,000 square-foot addition to our Middletown, Ohio, plant provides additional storage and office space. A small addition to the Sorgel transformer plant in Milwaukee, Wisconsin, plus the installation of new equipment, will help increase production of transformers.

The largest addition, the fourth in a series of planned expansions to our Lexington, Kentucky, plant, makes available more than 73,000 square feet of new manufacturing and office space, bringing the total area of that facility to almost 500,000 square feet. The installation of a new electro-deposition paint line will aid in production and provide improved quality.

NEW TEST LAB—ONE OF THE BEST IN THE COUNTRY

One of the most significant projects is the construction of a new test laboratory in Cedar Rapids, Iowa. When completed, it will be one of the most sophisticated high-power test labs in the United States. It will enable Square D to evaluate products and check their performance under the severe short circuit conditions which can occur in today's complex electrical distribution systems.

With the new laboratory, Square D will be able to qualify many of its products to both U.S. and international standards without resorting to outside laboratory facilities. This laboratory is being completed in stages, with total completion expected in 1980. By improving and expanding our test facilities now, Square D not only is able to meet today's expanded testing requirements but will be prepared for more sophisticated testing in the future as electrical standards continue to change.



A Square D employee in Costa Rica assembles a motor control center.



Lexington, Kentucky

NEW CENTRAL WAREHOUSE AND COMPUTER COMPLEX

Construction of a new central warehouse and computer center in Florence, Kentucky, continues on schedule. Involving over 480,000 square feet, the complex includes three structures: a 450,000 square-foot warehouse with a modern, six-high product stacking system; a 25,000 square-foot, two-level office and computer center; and a facility for vehicle maintenance. Installation of equipment is scheduled to start by mid-year. Total occupancy of the complex is planned by the end of 1979.

NEW CORPORATE HEADQUARTERS BUILDING

The occupancy of the new corporate headquarters building in Palatine, Illinois, is scheduled for this summer. We have outgrown our present building in Park Ridge, Illinois; and the new 152,000 square-foot structure will enable us to house all corporate personnel, currently operating out of several locations, in one facility.



Starkstrom Gummersbach

A GLOBAL APPROACH TO MANUFACTURING AND MARKETING

Square D has moved to unify its various manufacturing and marketing operations under one world-wide organization.

Standardization in manufacturing assures that, regardless of the origin of manufacture, all Square D products will be made to the same high quality standards but adapted to meet local, national or continental code requirements.

The unification of marketing operations will expand our marketing activities world-wide, enabling Square D to realize maximum effectiveness of its skilled marketing personnel and resources, wherever they are, and to take full advantage of marketing opportunities throughout the world, especially among developing nations.

EXPANDING INTO NEW MARKETS

Developing nations in Latin America, for example, offer a fertile potential market for our products. The discovery of oil in Mexico has triggered construction and industrial expansion in that country and other Latin American countries. To meet the demands in these countries, Square D has established manufacturing facilities in Costa Rica and Ecuador, which are producing and assembling several lines of Square D products. A plant in Brazil will be in production soon. A Latin American marketing organization similar to the one in the United States has been established with the location of field sales offices and a network of authorized distributors in major marketing locations.

The acquisition of Starkstrom Gummersbach, a highly regarded West German manufacturer of electrical control equipment, enables Square D

to participate further in international markets. Their equipment has been designed and rated to meet the national standards of many European countries as well as the requirements of the International Electro-technical Commission. This will enable Square D to sell electrical equipment to countries with different electrical standards from those in the U.S. Several Starkstrom products are being introduced into the Square D line, which will enable us to strengthen our competitive position domestically.



Expanding Our Technical Capabilities

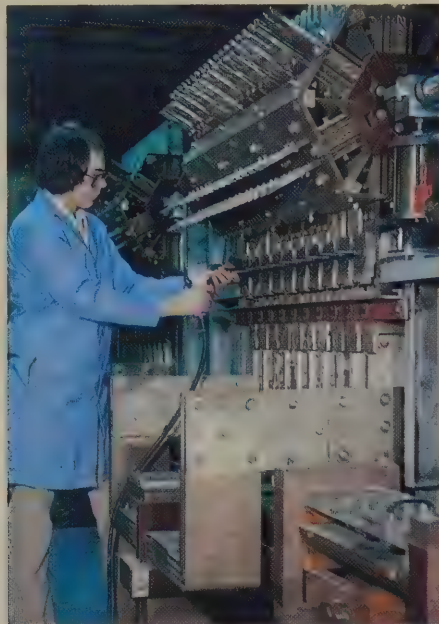
Several events made 1978 a significant year technologically for Square D.

The acquisition of Starkstrom enhanced the company's technical capabilities. Starkstrom's excellent design staff is a definite asset and will add greatly to Square D's over-all research and development program.

The SY/MAX-20™ Programmable Controller, an international research development, was introduced at a major trade show last fall. The SY/MAX-20 represents the best cooperative efforts of Square D electronics, engineering and marketing talent in Swindon, England, and Milwaukee, Wisconsin. The new controller will help us meet competition for systems products everywhere.

During the year, our SANSARC™ electrical contact material, introduced by Square D after five years of research and development, received recognition and an award from *Industrial Research and Development Magazine* as one of the top 100 technical products of 1977. SANSARC contact material was developed jointly by Square D Company, Milwaukee, and the Plessey Company, Limited of England. The new contact material not only conserves silver but improves the durability of electrical contact tips used in some electrical products.

The achievements mentioned above typify Square D's expanding world-wide technical capability. Increasingly, Square D's large technical centers in Milwaukee, Wisconsin; Cedar Rapids, Iowa; Lexington, Kentucky; Clearwater, Florida; and in England, Germany, Mexico and Canada are working together to solve technical problems. Square D design engineers also are working together to improve existing products and develop new ones to serve a changing and expanding industry. Square D research and development staffs everywhere are expanding to assure that Square D continues to maintain its leadership role in the design and development of products.



Expanding Our Product Capabilities

Square D Company has been a leader in the electrical industry in developing new products and procedures to make its products safer, more efficient and economical. In 1978 our research and development program resulted in the introduction of the POWER-CAST™ Transformer, the energy-saving WATCHDOG™ Energy Management System and the SY/MAX-20™ Programmable Controller, just to mention a few. These products further illustrate our expanded research and development capabilities.

SY/MAX-20™

The microprocessor, a tiny computer on a chip, makes possible the small size of the new SY/MAX-20 programmable controller. Used to control industrial automation, especially in the automotive and machine tool industries, the SY/MAX-20 controller replaces electro-mechanical systems and can handle arithmetical calculations and data storage, as needed in the operation of these systems. The portable programmer (lower left) is little larger than a pocket calculator.

Continued testing of our standard products also results in improved safety and performance. At Square D's short circuit test facilities, engineers continue to apply the concept of integrated equipment ratings to our products. This is a concept pioneered by Square D. An integrated equipment rating, or short-circuit rating which applies to an assembly of different devices that are combined to work together as a unit, means that the assembly has been tested as a unit. Prior to this, components were often tested individually and then assumed to have the same rating when used in an assembly, despite the fact that applications differed or other, non-tested devices also were involved.

Square D began testing for integrated equipment ratings as early as 1966, starting with I-LINE® Panelboards. Although such testing is time-consuming—it takes months and sometimes years to establish



EZ Meter-Pak®

Because the demand for more power for residential buildings increases the potential for higher and higher fault currents, the National Electrical Code now requires that equipment withstand available short circuit current. Square D multi-metering equipment for apartments and condominiums has passed all UL tests and now exceeds the capability of all competitive metering equipment. The new UL listings on Square D's Meter-Pak units allow contractors to comply with code requirements with more flexibility than ever before.



integrated ratings on some devices — many Square D products are tested for integrated ratings and have the rating inscribed on the assembly.

The National Electrical Code now requires integrated equipment ratings on a number of assemblies, and standards based on those originally developed by Square D have been adopted by Underwriters' Laboratories and the National Electrical Manufacturers' Association.



WATCHDOG™ Energy Management System

The WATCHDOG energy management system is designed for commercial and light industrial buildings with monthly electric bills of \$1,000 or more. The WATCHDOG system, which can be operated without special training, controls eight electrical loads or groups of loads from a compact 18" x 14" x 6" device. Savings on utility bills typically pay for the cost of the equipment within a year.

I-LIMITER™ Current-Limiting Circuit Breaker

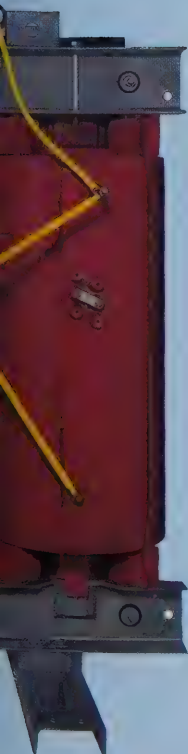
Square D's I-LIMITER current-limiting circuit breaker, introduced in 1975, was the first practical circuit breaker to limit prospective peak fault currents from 230,000 amperes to less than 25,000 amperes—all in less than one-thousandth of a second. Now, a second, larger I-LIMITER breaker has been introduced. Because of their current limiting ability, these devices allow the use of conventional equipment in the circuits they are protecting. The ability to use conventional equipment represents a substantial cost saving, particularly in large electrical systems of shopping plazas, commercial buildings and factories.

POWER-CAST™ Transformers

Square D's newest transformer for utilities and large industrial complexes, this 11,000 pound cast epoxy resin transformer has an impulse voltage withstandability equal to that of liquid-filled types without the electrical environmental problems associated with oil or non-inflammable liquids.

Switchboards

Some switchboards and motor control centers rated at 600-volt AC maximum, like the one shown here, are UL-listed, with distribution interiors that have integrated equipment ratings. These are available from distributor stock. Previously, most switchboards and motor control centers had to be individually engineered and factory assembled.



Consolidated Balance Sheets

(Dollars in thousands, except per share)

	December 31	
	1978	1977
Assets:		
Current Assets:		
Cash	\$ 14,168	\$ 5,851
Short-term investments, at cost (approximates market)	34,199	55,534
Receivables, less allowances for losses, adjustments and discounts (1978—\$2,764; 1977—\$1,958)	113,426	82,981
Inventories (Note C)	131,751	115,574
Insurance and other prepaid expenses	4,086	3,419
Deferred income taxes	4,026	2,743
Total Current Assets	301,656	266,102
Property, Plant and Equipment, at cost:		
Land	7,928	7,844
Buildings and land improvements	102,050	76,105
Equipment	146,959	119,871
	256,937	203,820
Less accumulated depreciation	86,950	77,656
	169,987	126,164
Other Assets	2,097	1,807
Excess of Purchase Price Over Net Assets of Businesses Acquired	8,755	4,775
	\$482,495	\$398,848
Liabilities and Shareholders' Equity:		
Current Liabilities:		
Short-term debt	\$ 4,911	\$ 5,240
Current maturities of long-term debt	1,737	1,405
Accounts payable and accrued expenses	68,801	44,596
Income taxes	15,225	16,359
Dividend payable January 2	8,938	8,341
Total Current Liabilities	99,612	75,941
Long-Term Debt (Note E)	75,768	53,322
Deferred Income Taxes	17,156	12,635
Minority Interest in Subsidiaries	2,277	2,021
Shareholders' Equity:		
Preferred stock, no par value, authorized 6,000,000 shares, none issued	—	—
Common stock, par value \$1.66 2/3, authorized 30,000,000 shares, issued and outstanding 23,833,044 shares (Note J)	39,722	39,718
Additional paid-in capital	13,885	13,833
Retained earnings (Note E)	234,075	201,378
Total Shareholders' Equity	287,682	254,929
	\$482,495	\$398,848

See notes to consolidated financial statements.

Consolidated Statements of Net Earnings

(Dollars in thousands, except per share)

	Year Ended December 31	
	1978	1977
Revenues:		
Net sales	\$726,862	\$610,754
Interest and miscellaneous (Note D)	4,537	5,833
	731,399	616,587
Costs and Expenses:		
Cost of products sold	476,640	400,445
Selling, service, administrative and general	117,049	93,882
Interest	6,921	5,515
	600,610	499,842
Earnings before Income Taxes	130,789	116,745
Provision for Income Taxes (Note F)	64,132	57,821
Net Earnings	\$ 66,657	\$ 58,924
Net earnings per share based on weighted average number of shares outstanding during the year	\$ 2.80	\$ 2.47

Consolidated Statements of Changes in Financial Position

(Dollars in thousands)

Source of Funds:

Operations:		
Net earnings	\$ 66,657	\$ 58,924
Depreciation and amortization	11,892	9,306
Deferred income taxes	3,238	4,059
Total from operations	81,787	72,289
Increase in accounts payable and accrued expenses . . .	24,205	2,728
Long-term debt incurred	24,005	8,375
Decrease in cash and short-term investments	13,018	(3,539)
Disposal of property, plant and equipment	241	919
Exercise of stock options	56	158
	\$143,312	\$ 80,930

Use of Funds:

Additions to property, plant and equipment	\$ 55,503	\$ 31,814
Dividends to shareholders	33,960	29,787
Increase in receivables	30,445	12,861
Increase in inventories	16,177	11,269
Excess of purchase price over net assets of Starkstrom Gummersbach (Note B)	4,241	—
Payments on long-term debt	1,337	780
Decrease in income taxes payable	1,134	(3,319)
Decrease in short-term debt	329	(1,445)
Miscellaneous	186	(817)
	\$143,312	\$ 80,930

See notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

(Dollars in thousands, except per share)

	Common Stock		Additional Paid-in Capital	Retained Earnings
	Shares	Amount		
Balance, January 1, 1977	23,823,244	\$39,706	\$13,687	\$172,241
Exercise of stock options	7,100	12	146	
Net earnings				58,924
Cash dividends (\$1.25 per share)				(29,787)
Balance, December 31, 1977	23,830,344	39,718	13,833	201,378
Exercise of stock options	2,700	4	52	
Net earnings				66,657
Cash dividends (\$1.42 1/2 per share)				(33,960)
Balance, December 31, 1978	23,833,044	\$39,722	\$13,885	\$234,075

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Years Ended December 31, 1978 and 1977

(Dollars in thousands, except per share)

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and all of its subsidiaries.

Inventories

Inventories are stated at the lower of cost or market. The last-in, first-out (LIFO) method is used to determine cost of inventories in the United States. The first-in, first-out (FIFO) method is used to determine cost of foreign inventories.

Depreciation

Depreciation of property, plant and equipment is provided primarily on a straight-line basis generally over the estimated useful lives of the assets. Accelerated methods are used for tax purposes.

Businesses Acquired

The excess of purchase price over net assets of businesses acquired is amortized on a straight-line basis over forty years.

Income Taxes

Deferred income taxes are provided on timing differences between financial and taxable earnings. The principal differences relate to receivables allowances, depreciation, inventory valuations, elimination of inter-company transactions and those unremitted earnings of foreign subsidiaries which are not considered to be

permanently invested. Investment tax credits are recognized using the flow-through method.

Pension Plans

The Company funds and charges to operations current service pension costs and amortization of prior service costs over a period not in excess of thirty years.

B. ACQUISITION

On February 16, 1978, the Company acquired Starkstrom Gummersbach GmbH, a West German manufacturer of industrial control equipment for cash of \$14,954. The acquisition was accounted for under the purchase method of accounting. The results of operations of Starkstrom Gummersbach from the date of acquisition are included in the consolidated results of the Company. The effects of this acquisition on revenues and net earnings for periods prior to acquisition were not material.

C. INVENTORIES

If the first-in, first-out (FIFO) method of inventory accounting had been used by the Company, inventories would have been \$77,860 and \$69,629 higher than reported at December 31, 1978 and 1977, respectively.

D. INTEREST AND MISCELLANEOUS

Interest and miscellaneous revenues for 1977 include a gain on sale of equipment of \$2,574.

Notes to Consolidated Financial Statements

E. LONG-TERM DEBT

Long-term debt consists of the following:

	December 31	
	1978	1977
Senior Notes, 10.125%, due 1999	\$40,000	\$40,000
Industrial Revenue Bonds, 5.6% to 8.8%, due on various dates to 2003	19,970	10,480
First Mortgage Notes, 9.2%, due on various dates to 2009	9,034	1,066
Payable to banks, average rate 12%, due on various dates to 1987	6,593	2,331
Other debt, 6% to 10.5%, due on various dates to 1988	1,908	850
	<u>77,505</u>	<u>54,727</u>
Less current maturities	<u>1,737</u>	<u>1,405</u>
	<u>\$75,768</u>	<u>\$53,322</u>

The Senior Notes are unsubordinated, unsecured and mature on November 1, 1999, with annual repayments of \$2,000 beginning in 1980. Under the terms of the note agreement, the Company may pay dividends up to \$20,000 plus the proceeds from the sale of stock and the consolidated net income for periods subsequent to December 31, 1973. At December 31, 1978, \$121,098 of retained earnings was unrestricted for dividends.

The Industrial Revenue Bonds and the First Mortgage Notes are secured by the property and equipment acquired with the proceeds of the financing.

F. INCOME TAXES

The provision for income taxes consists of the following:

	1978	1977
Current income taxes:		
U.S. Federal	\$50,027	\$44,341
State	6,535	5,338
Foreign	4,332	4,083
Deferred income taxes	3,238	4,059
	<u>\$64,132</u>	<u>\$57,821</u>

U.S. income taxes have not been provided on unremitted earnings of foreign subsidiaries considered to be permanently invested amounting to \$29,405 at December 31, 1978.

G. RESEARCH AND DEVELOPMENT COSTS

Research and development costs were \$12,718 in 1978 and \$10,034 in 1977.

H. PENSION PLANS

The Company has several defined benefit pension plans, primarily noncontributory, covering substantially all employees for retirement benefits at age 65. The total pension expense was \$6,927 for 1978 and \$6,571 for 1977. The actuarially computed value of vested benefits as of the latest valuation date, January 1, 1978, exceeded pension fund assets by approximately \$10,222. The actuarially computed unfunded past service cost as of January 1, 1978, amounted to approximately \$23,826.

I. LEASE COMMITMENTS

The Company rents various warehouse, office and manufacturing facilities, and certain equipment, principally transportation and data processing, under lease arrangements classified as operating leases.

Future minimum rental payments under noncancelable operating leases with initial or remaining terms of one year or more as of December 31, 1978, were:

1979	\$ 5,034
1980	3,230
1981	2,019
1982	1,704
1983	908
Remainder	<u>57</u>
	<u>\$12,952</u>

Rental expense under operating leases was \$10,967 for 1978 and \$8,985 for 1977.

J. STOCK INCENTIVE PLANS

A Stock Appreciation Rights Plan was approved by the shareholders of the Company during 1978. Each Stock Appreciation Right (SAR) granted under the Plan entitles the grantee to receive at the end of the period for which the SAR is granted (from six months to five years) the appreciation in the fair market value of one share of Common Stock of the Company during the designated period. Distribution of the appreciation will be one-half in cash and one-half in shares of the Company's Common Stock valued at fair market value on the last day of the designated period of the SAR.

There are 500,000 shares of Common Stock reserved at December 31, 1978, for issuance under the Stock Appreciation Rights Plan. At December 31, 1978, 153,700 SARs granted during 1978 were outstanding.

The Company has ceased granting options under existing Employees' Stock Option Plans. Stock options previously granted, which expire at various dates through 1987, will not be affected unless surrendered in connection with the granting of SARs.

Common shares under option changed as follows:

	1978		1977	
	Number of Shares	Average Price Per Share	Number of Shares	Average Price Per Share
Options outstanding January 1	386,700	\$24.04	332,200	\$24.46
Granted	—		93,100	25.88
Exercised	(2,700)	19.97	(7,100)	18.90
Cancelled or expired	(34,400)	25.16	(31,500)	35.05
Surrendered for Stock Appreciation Rights	(133,400)	28.23	—	
Options outstanding and exercisable, December 31	<u>216,200</u>	<u>21.33</u>	<u>386,700</u>	<u>24.04</u>

Notes to Consolidated Financial Statements

K. SEGMENTS OF BUSINESS

Square D is engaged in the manufacture and sale of electrical equipment, considered by the Company to be a single line of business, and operates predominately in this industry.

Net sales made to a group of customers under common control were \$87,238 in 1978 and \$75,207 in 1977.

Operations by Geographic Areas:	<u>United States</u>	<u>Foreign</u>	<u>Eliminations</u>	<u>Consolidated</u>
For the year ended December 31, 1978:				
Revenues:				
Unaffiliated transactions	\$625,892	\$105,507	\$ —	\$731,399
Intercompany transactions	20,139	1,276	(21,415)	—
	<u>\$646,031</u>	<u>\$106,783</u>	<u>\$(21,415)</u>	<u>\$731,399</u>
Earnings Before Income Taxes	<u>\$125,349</u>	<u>\$ 6,000</u>	<u>\$ (560)</u>	<u>\$130,789</u>
Identifiable Assets at December 31, 1978	<u>\$388,897</u>	<u>\$128,140</u>	<u>\$(34,542)</u>	<u>\$482,495</u>
For the year ended December 31, 1977:				
Revenues:				
Unaffiliated transactions	\$535,536	\$81,051	\$ —	\$616,587
Intercompany transactions	21,424	482	(21,906)	—
	<u>\$556,960</u>	<u>\$81,533</u>	<u>\$(21,906)</u>	<u>\$616,587</u>
Earnings Before Income Taxes	<u>\$111,384</u>	<u>\$ 6,304</u>	<u>\$ (943)</u>	<u>\$116,745</u>
Identifiable Assets at December 31, 1977	<u>\$335,127</u>	<u>\$89,555</u>	<u>\$(25,834)</u>	<u>\$398,848</u>

Transactions between geographical areas are accounted for primarily at cost plus a markup to approximate market.

Foreign currency exchange losses were \$2,032 in 1978 and \$6 in 1977.

L. SUMMARY OF QUARTERLY RESULTS (UNAUDITED)

Quarter Ended	Net Sales	Cost of Products Sold	Net Earnings	Net Earnings Per Share
1978				
March 31	\$161,775	\$104,738	\$14,549	\$.61
June 30	180,161	117,128	16,848	.71
September 30	188,027	123,472	17,467	.73
December 31	196,899	131,302	17,793	.75
1977				
March 31	141,997	94,544	12,581	.53
June 30	152,670	101,032	15,910	.66
September 30	162,888	107,567	16,135	.68
December 31	153,199	97,302	14,298	.60

Notes to Consolidated Financial Statements

M. REPLACEMENT COST (UNAUDITED)

The Company has realized substantial gains over the past several years in sales dollars. This increase in sales dollars is in part due to price increases sufficient to cover inflation costs and thus prevent erosion of margins which would otherwise occur. Price increases are restricted to some degree by competitive factors; however, the Company attempts to maintain margins through improved product design, cost control and price increases where appropriate.

Although the cumulative impact of inflation over a number of years has resulted in higher costs for replacement of plant and equipment, such inflationary increases

have been partially offset by technological improvements and design changes which often result in operating efficiencies and increased productivity. The majority of asset additions in the past has been for expansion rather than replacement of existing assets.

Quantitative information with respect to the estimated replacement cost of inventory, plant and equipment, and the related estimated effect of such costs on cost of sales and depreciation expense, is contained in the Company's Annual Report to the Securities and Exchange Commission on Form 10-K, a copy of which is available to shareholders upon request.

Auditors' Report

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS
SQUARE D COMPANY
PARK RIDGE, ILLINOIS

We have examined the consolidated balance sheets of Square D Company and subsidiaries as of December 31, 1978 and 1977, and the related consolidated statements of net earnings, shareholders' equity and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the financial position of Square D Company and subsidiaries at December 31, 1978 and 1977, and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Chicago, Illinois
January 26, 1979

TOUCHE ROSS & CO.

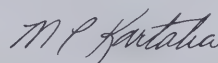
Responsibilities for Financial Statements

The financial statements of Square D Company and subsidiaries were prepared under the direction of management which is responsible for their integrity and objectivity. The statements have been prepared in conformity with generally accepted accounting principles and, as such, include amounts based on judgment of management.

Management has developed a system of internal controls which is designed to assure that the books and records accurately reflect the transactions of the Company and that its established policies and procedures are followed properly. This system is augmented by written policies and procedures, a program of internal audit, and the selection and training of qualified personnel.

Touche Ross & Co., independent certified public accountants, are engaged to examine the financial statements of Square D Company and its subsidiaries and issue reports thereon. Their examination is conducted in accordance with generally accepted auditing standards and includes a review of internal controls and a test of transactions.

The Board of Directors, acting upon the advice and recommendations of the Audit Committee, is responsible for assuring that management fulfills its responsibilities in the preparation of the financial statements and for engaging the independent public accountants with whom the Committee reviews the scope of the audits and the accounting principles to be applied in financial reporting. The Audit Committee is composed of outside directors who meet regularly with the independent public accountants, representatives of management, and the internal auditors to review the activities of each and to ensure that each is properly discharging its responsibilities. There is unrestricted access to the Audit Committee by both the independent auditors and internal auditors, without management representatives present, to discuss the results of their examinations and their opinions on the adequacy of internal controls and the quality of financial reporting.



Chairman of the Board



Chief Financial Officer

Management Review

BUSINESS

Square D Company is engaged in the manufacture and sale of electrical equipment and its products are sold in virtually every major marketing area in the world. Major manufacturing plants are located throughout the United States and in Canada, Mexico, England, Ireland, West Germany, Italy and Australia. The Company is presently engaged in expanding operations in Latin America and the Far East.

Most products are marketed through the Company's own marketing organization and distributed through a system of strategically located warehouses. The majority of all sales are made directly to authorized electrical

distributors who, in turn, market the products to electrical contractors, electrical utilities, large industrial plants and other classes of trade. Although the Company does employ a few independent sales agents, the majority of all products are sold through the Company's own marketing organization which is staffed by field engineers who are the primary contact with present and potential customers and users. These field engineers or technical sales representatives are supported by product specialists and customer service personnel headquartered at major manufacturing plants.

FIVE YEAR COMPARISON

(In thousands, except per share)

	1978	1977	1976	1975	1974
SUMMARY OF OPERATIONS					
Net sales	\$726,862	\$610,754	\$528,849	\$460,364	\$471,123
Interest and miscellaneous income	4,537	5,833	3,421	2,180	1,841
Cost of products sold	476,640	400,445	356,035	316,300	328,259
Selling, service, administrative and general expenses	117,049	93,882	82,527	72,090	68,412
Interest expense	6,921	5,515	5,371	5,438	6,715
Earnings before income taxes	130,789	116,745	88,337	68,716	69,578
Provision for income taxes	64,132	57,821	44,065	32,859	32,906
Net earnings	66,657	58,924	44,272	35,857	36,672
Average shares outstanding	23,832	23,829	23,818	23,805	23,801
Net earnings per share	\$ 2.80	\$ 2.47	\$ 1.86	\$ 1.50	\$ 1.54
Cash dividends per share	1.42½	1.25	1.10	1.10	1.10
TOTAL ASSETS	\$482,495	\$398,848	\$350,886	\$312,093	\$315,691
FINANCIAL INFORMATION					
Working capital	\$202,044	\$190,161	\$173,359	\$161,315	\$160,297
Property, plant and equipment	169,987	126,164	104,575	94,989	92,693
Long-term debt	75,768	53,322	46,199	45,919	55,023
Shareholders' equity	287,682	254,929	225,634	207,189	197,447
Shares outstanding	23,833	23,830	23,823	23,805	23,805
Shareholders' equity per share	\$ 12.07	\$ 10.70	\$ 9.47	\$ 8.70	\$ 8.29
Capital expenditures	\$ 55,503	\$ 31,814	\$ 19,039	\$ 11,254	\$ 17,891
Depreciation and amortization	11,892	9,306	8,553	8,383	7,516

Management Review

COMMON STOCK

Square D Company's common stock is traded on the New York Stock Exchange. The high and low sales

prices and the dividends per share by quarter for 1978 and 1977 were:

	Market Price		Dividends	
	High	Low	Paid	Declared
1978				
First Quarter	\$26 $\frac{7}{8}$	\$22 $\frac{3}{8}$	\$.35	\$.35
Second Quarter	27	22 $\frac{3}{8}$	.35	.35
Third Quarter	26 $\frac{1}{4}$	23 $\frac{1}{4}$	.35	.35
Fourth Quarter	24 $\frac{1}{2}$	19 $\frac{5}{8}$	.35	.37 $\frac{1}{2}$
	Market Price		Dividends	
	High	Low	Paid	Declared
1977				
First Quarter	\$28 $\frac{7}{8}$	\$24	\$.27 $\frac{1}{2}$	\$.30
Second Quarter	29 $\frac{5}{8}$	25 $\frac{5}{8}$	.30	.30
Third Quarter	29	23 $\frac{1}{2}$	.30	.30
Fourth Quarter	27 $\frac{5}{8}$	23 $\frac{3}{4}$	.30	.35

Note: Dividends are generally declared in the last month of each quarter payable in the first month of the following quarter.

Management Review

MANAGEMENT'S REVIEW AND ANALYSIS OF OPERATIONS

1978 Compared to 1977

Netsales in 1978 increased \$116.1 million, or 19 percent, over 1977. The increase is primarily the result of increased volume of shipments but also reflects moderate price increases on certain products. Improvements in those sectors of the economy in which the Company is involved, principally new building construction and capital investment in machinery, have contributed to the increase in sales.

Interest and miscellaneous income was lower in 1978 because 1977 results include a \$2.6 million gain on the sale of equipment. This reduction was partially offset by an increase in interest income.

Cost of products sold increased \$76.2 million, or 19 percent, due to increased sales volume and start-up costs of new operations, both domestic and foreign.

Selling, service, administrative, and general expenses increased \$23.2 million, or 25 percent, over 1977. In addition to the general increase in business activity, these expenses were further increased by foreign currency exchange losses and expenses of new international operations. The increase in foreign currency exchange losses of \$2.0 million was primarily the result of fluctuations between the U.S. dollar, Canadian dollar, English pound sterling, Brazilian cruzeiro, Mexican peso

and the West German mark. New operations being developed in Central and South America and the newly acquired subsidiary in West Germany contributed to the increase in expenses. However, since most of these operations are still in the development stage, they have not contributed to sales in the same relationship as their expense contribution.

Interest expense increased \$1.4 million, or 25 percent, primarily as a result of an increase in Industrial Revenue Bonds and new debt relating to foreign operations.

The provision for income taxes increased from \$57.8 million in 1977 to \$64.1 million in 1978. There was a slight reduction in the effective tax rate, from 49.5 percent for 1977 to 49.0 percent for 1978. The reduction is due primarily to a greater level of investment tax credit in 1978 partially offset by an increase in the level of state income taxes.

Net earnings for 1978 increased \$7.7 million over 1977. Included in 1977 net earnings is a gain on the sale of equipment of \$1.4 million. Net earnings from operations increased approximately \$9.1 million, or 16 percent, over 1977. The increase in net earnings results from higher sales volume and effective control over costs of operations.

Management Review

MANAGEMENT'S REVIEW AND ANALYSIS OF OPERATIONS

1977 Compared to 1976

In 1977 sales increased by \$81.9 million, or 15 percent, as compared to 1976. The increase is primarily the result of increased volume but also includes moderate price increases on certain products during 1977. The increased volume in 1977 reflects the continued recovery in the economy from that of 1976.

Interest and miscellaneous income increased due to a gain on the sale of equipment of \$2.6 million in 1977.

Cost of products sold increased by \$44.4 million, or 12 percent, as a result of the increased sales volume. The increase in cost of products sold was at a lower rate than sales because of improved utilization of productive capacity and continued emphasis on profit improvement programs which enabled the Company to realize improved profit margins.

Selling, service, administrative and general expenses increased with the expanded level of business activity. The increase in 1977 was \$11.4 million, or 14 percent.

Operations in 1977 were not materially affected by currency losses as compared to currency losses in 1976 of \$2.1 million.

The provision for income taxes increased from \$44.1 million in 1976 to \$57.8 million in 1977. There was a slight reduction in the effective tax rate from 49.9 percent to 49.5 percent. The effective tax rate was reduced by lower taxes on earnings of foreign operations. This reduction was partially offset by a higher effective tax rate on earnings of U.S. operations due to a lower percentage of investment tax credit related to earnings before income taxes and an increase in state taxes.

Net earnings in 1977 increased \$14.7 million, or 33 percent, as compared to 1976. The increase was primarily the result of increased sales and improved utilization of productive capacity. Continued emphasis on profit improvement programs and the decline in the rate of inflation in 1977 also contributed to improved earnings.

OPERATIONS

Domestic Operations

Manufacturing Plants

Asheville, N.C.
Bronx, N.Y.
Cedar Rapids, Ia.
Chicago, Ill.
Clanton, Ala.
Clearwater, Fla.
Columbia, Mo.
Columbia, S.C.
Emmaus, Pa.
Helena, Ala.
Huntington, Ind.
Leeds, Ala.
Lexington, Ky.
Lincoln, Nebr.
Mesquite, Tex.
Middletown, Ohio
Milwaukee, Wis. (2 plants)
Orting, Wash.
Oshkosh, Wisc.
Oxford, Ohio
Peru, Ind.
Raleigh, N.C.
Three Rivers, Mich.

Assembly Plants

Atlanta, Ga.
Chicago, Ill.
Dallas, Tex.
Denver, Colo.
Detroit, Mich.
Los Angeles, Calif.
Seattle, Wash.
Secaucus, N.J.

Physical Distribution System

Warehouse Locations

Atlanta, Ga.
Chicago, Ill.
Dallas, Tex.
Florence, Ky.
Los Angeles, Calif.
Lyndhurst, N.J.
Seattle, Wash.

Wholly-Owned Domestic Subsidiary

Ferro Fabricating Company, Inc.
Birmingham, Ala.

Non-Domestic Operations

Square D Company Canada Limited—Toronto
Manufacturing Plants in Toronto, Stratford,
Edmundston and Arnprior; assembly facilities
in Edmonton and Montreal; warehouses in
Edmonton, Montreal, Toronto, Vancouver
and Winnipeg.

Square D Limited—Esher, England
Manufacturing Plant in Swindon

Square D de Mexico, S.A.—Mexico City, Mexico
(2 plants)
Versamex, S.A. de C.V., Mexico City

Square D Andina, S.A.—Latacunga, Ecuador

Square D do Brasil Equipamentos
Eletricos Ltda.—Sao Paulo, Brazil

Square D Centroamericana, S.A.
San Jose, Costa Rica

Square D Italia, S.p.A.—Arenzano, Italy

Square D Company Australia Pty. Limited
Melbourne, Australia

Square D Electrical Products Pty. Limited
Johannesburg, South Africa

Palatine Ridge Insurance Company Limited
Hamilton, Bermuda

Square D Company Ireland Limited
Ballinasloe, Irish Republic

Square D France S.A.—Paris, France

Square D GmbH—Darmstadt, West Germany

Starkstrom Gummersbach GmbH, West Germany
Manufacturing Plants in Rodt and Volperhausen



Square D Company Executive Plaza Park Ridge, Illinois 60068

Printed in U.S.A.